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DEPARTMENT OF ENERGY, LABOR & ECONOMIC GROWTH
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The State of Competition in the Commercial Liability Insurance Market In the State of Michigan

A Market Competition Study issued by Commissioner Ken Ross

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Office of Financial and Insurance Regulation

Over the last several decades, the insurance, banking and securities markets have become very complex and an antiquated regulatory model could not keep pace with the ever changing marketplace. In April of 2000, Michigan became the first state to coordinate the regulation of insurance, financial institutions and securities into one governmental agency consistent with financial services modernization and created the Office of Financial and Insurance Services (OFIS) by executive order. The creation of OFIS allowed Michigan regulators to become adept at interpreting and regulating complex service entities that emerged over the previous few years.

On February 1, 2008, Governor Granholm signed Executive Order 2008-02, which became effective April 6, 2008. The order changed the official name of OFIS to the Office of Financial and Insurance Regulation (OFIR) to reflect its regulatory and consumer protection focus.

The OFIR is responsible for the regulation of Blue Cross Blue Shield, 26 HMOs, 127 banks, 174 domestic insurance companies, 210 credit unions, 1,427 foreign insurance companies, 1,858 investment advisers, 2,036 securities broker-dealers, 6,172 consumer finance lenders, 171,443 insurance agents, and 123,604 securities agents. It licenses, registers, or charters these entities, conducts safety, soundness, and compliance examinations, and protects and educates Michigan consumers of financial services. Through adaptability and consumer communication, the Commissioner and staff of the OFIR strive to be the preeminent financial regulators in the United States (U.S.).

Executive Summary

This report reviews and evaluates the state of competition in the commercial liability insurance market in Michigan for calendar year 2009 as required by Michigan Compiled Laws (MCL) 500.2409c. Its purpose is to determine whether a reasonable degree of competition exists in the commercial liability insurance market on a statewide basis in Michigan.

Economic analysis was used to determine whether current structure, conduct, and performance are conducive to workable competition. As a result of the analysis and review of the data, it was determined that a reasonable degree of competition exists statewide in the Michigan commercial liability insurance market.

Historical Perspective

The current state insurance regulatory framework started in the 19th century with the appointment of the first state insurance commissioner in New Hampshire in 1851. The regulation of insurance has grown in scope and complexity as the industry evolved. Authorized by Congress in 1945, the McCarran-Ferguson Act affirmed that the continued state regulation of insurance was in the public's best interest and declared that states should continue to regulate the business of insurance.

Insurance is a legal contract and is rooted in the tort and social policy laws of each state. Historically, government regulated insurance, financial institutions (banking, consumer finance and credit unions), and securities separately. A depression-era federal law known as the Glass Steagall Act (adopted in response to the bank failures following the 1929 stock market crash) specifically prohibited a bank from offering securities and insurance products or engaging in commercial banking. The Glass Steagall Act was repealed by the Financial Services Modernization Act of 1999, also known as the Graham Leach Bliley Act (GLBA). This permitted affiliations among banks, securities firms and insurance companies, and allowed the insurance companies to compete in the newly integrated financial market.

The Bureau of Labor Statistics reported about 480,000 businesses in the U.S. finance and insurance sector in 2009. The Bureau of Economic Analysis (BEA) provides the measure of industry's economic output that is defined as gross domestic product (GDP). One key feature of the GDP by industry accounts is the value-added estimates for all industries. As a component of GDP, value-added is a measure of the incomes earned in production in each industry. It is also a measure of an industry's contribution to GDP. The main components of value added include the returns to labor (as measured by compensation of employees), returns to capital (as measured by gross operating surplus), returns to industries, the incomes generated by production, and the size and scope of an industry's market.

Value-added by Industry as a Percent of Gross Domestic Product
[Percent] Release date: April 28, 2010

Line		**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
1	**Gross domestic product**	100.0	100.0	100.0	100.0	100.0	100.0
50	Finance, insurance, real estate, rental, and leasing	20.3	20.6	20.7	20.6	21.1	21.4
51	**Finance and insurance**	7.8	8.1	8.3	8.0	8.3	8.4
52	Federal Reserve banks, credit intermediation, and related activities	3.7	3.7	3.6	3.4	3.4	N/A
53	Securities, commodity contracts, and investments	1.2	1.4	1.6	1.4	1.4	N/A
54	Insurance carriers and related activities	2.7	2.7	2.7	2.8	3.2	N/A
55	Funds, trusts, and other financial vehicles	0.3	0.3	0.3	0.3	0.4	N/A

Source: Bureau of Economic Analysis

These statistics were prepared by the Industry Economic Accounts Directorate, BEA, U.S. Department of Commerce. Revised statistics for all years are consistent with the 2010 comprehensive revision of the annual industry accounts released on May 25, 2010.

Unlike the financial market, which is about risk-taking and access to credit, the insurance market operates as a legal promise, a guarantee against risk, paying a covered liability claim or lawsuit when certain events occur. Despite the size and scope of the insurance sector, private markets in commercial liability insurance are often inefficient, producing high rates and reduced availability. The hard-market of the mid-1980s which was represented with an overall increase in rates and reduced availability caused a public outcry for lower commercial liability insurance and lower litigation costs.

The Michigan Legislature enacted changes in the tort liability law, MCL 600.2956, MCL 600.2957, and MCL 600.6304, to reduce unwarranted litigation. The Insurance Code of 1956 was amended to require the former Insurance Bureau (now OFIR) to conduct annual research and report whether a reasonable degree of competition in the commercial liability insurance market exists on a statewide basis. Competitive forces will define market structure, conduct and performance of the Michigan commercial liability market.

Introduction

Commercial liability insurance is defined in the Michigan Insurance Code of 1956 as insurance which provides indemnification for commercial, industrial, professional, or business liabilities. The OFIR Commissioner regulates the insurance marketplace in Michigan. Michigan Insurance Code of 1956, MCL 500.2409c, states the Commissioner shall make an annual determination as to whether a reasonable degree of competition in the commercial liability insurance market exists on a statewide basis. If the Commissioner determines that a reasonable degree of competition in the commercial liability insurance market does not exist on a statewide basis, the Commissioner shall hold a public hearing and shall issue a report delineating specific classifications and kinds or types of insurance, if any, where competition does not exist.

This report covers the commercial liability market not covered by the following three required reports:

The State of Competition in the Workers' Compensation Insurance Market in the State of Michigan

Section 500.2409 requires that the Commissioner make a determination as to whether a reasonable degree of competition in the workers' compensation insurance market exists on a statewide basis.

The Availability and Pricing of Liquor Liability Insurance

Section 500.2409b requires the Commissioner to issue a report detailing the state of availability in the liquor liability insurance market.

Evaluation of the Michigan Medical Professional Liability Insurance Market

Section 500.2477d requires the Commissioner to publish a report every 2 years which does all of the following:

(a) Describes the condition of the medical malpractice insurance market in this state.
(b) Contains information regarding specific claims experiences filed with the Commissioner pursuant to sections 2477 to 2477c.
(c) Makes recommendations concerning the medical malpractice insurance market in this state.

Elements considered in determining State of Competition

MCL 500.2409c states that all of the following shall be considered by the Commissioner for purposes of determining that a reasonable degree of competition exists in the commercial liability insurance market on a statewide basis:

(a) The extent to which any insurer controls the commercial liability insurance market, or any portion of the commercial liability insurance market.
(b) Whether the total number of companies writing commercial liability insurance in this state is sufficient to provide multiple options to commercial liability insurance purchasers.
(c) The disparity among commercial liability insurance rates and classifications to the extent that such classifications result in rate differentials.
(d) The availability of commercial liability insurance to commercial liability insurance purchasers in all geographic areas and all types of business.
(e) The residual market share.

Standards of Competition Applied in this Study

Economic theory provides that an industry is perfectly competitive only when there are a large number of businesses selling a homogenous commodity and each business' share of the market is so small that no business' output decisions are able to affect the price of the commodity. In addition, under perfect competition, there are no barriers to the entry of new businesses and resources can easily enter and exit an industry. Buyers and sellers are fully informed as to market conditions.

Since the conditions for perfect competition are ideal, they would not likely be found in the real world. Accordingly, OFIR uses workable competition as the standard for evaluating the Michigan commercial liability insurance market. A market is considered as workably competitive when it reasonably approaches the structural, conduct, and performance characteristics of perfect competition.

Market structure is determined by the number and size distribution of buyers and sellers, extent of barriers to entry into the market, cost structures, availability of information to buyers and sellers and degree of product differential. Market conduct reflects the behavior of firms in pricing, setting output levels, designing products, advertising, innovation, and capital investment. Market performance refers to price, profit and output levels, and the degree of cost efficiency and the rate of technological progress.

While the above conditions for perfect and workable competition apply to a static analysis, the underwriting cycle plays a role in the short-term performance of the commercial liability insurance industry.

The underwriting cycle is characterized by alternating periods of increasing and decreasing competition. Competitive or "soft" markets are characterized by falling rates, increasing availability, growing loss ratios (less profit), and diminishing surpluses. These conditions eventually raise loss ratios sufficiently to cause insurers to raise their rates and reduce their volume (decreasing availability). The hard market is the period during which underwriting standards are very tight and the rates are high, which ultimately restores profitability and surplus to the insurer. This in turn ushers in renewed price-cutting and increased availability continuing the cycle.

One of the questions to be answered through this study is to determine where in the underwriting cycle was the Michigan commercial liability insurance market in 2009.

The main factors to be considered in determining the state of competition in the Michigan commercial liability insurance market are the extent to which any insurer controls all or a portion of the commercial liability insurance market and whether the total number of companies writing commercial liability insurance in this state is sufficient to provide multiple options to its clients. The market's performance in pricing and availability must be considered. Are there rate differentials which result from disparity among commercial liability insurance rates and classifications? Is the overall rate level excessive, inadequate, or unfairly discriminatory? Is there availability of commercial liability insurance to clients in all geographic areas and all types of businesses in this state? What does the size of the residual market share tell us? In effect, a competitive market structure causes firms to conduct business in a competitive manner that leads to market performance advantages for the consumer.

Data Collection

For the calendar year ending December 31, 2009, OFIR collected, analyzed and reviewed data from different sources including the National Association of Insurance Commissioners (NAIC), Council of Insurance Agents & Brokers (CIAB), and information in the OFIR database to determine whether a reasonable degree of competition exists in the commercial liability insurance market on a statewide basis in Michigan.

In Michigan, except for workers' compensation insurers, commercial liability insurance carriers are exempt from the requirement of filing insurance rates with OFIR. If we could look at rates, one would have to keep in mind that the rate change history for the leading writers of commercial liability insurance is not a precise measure of overall rate levels for the entire industry. Commercial liability insurers may not move in lock step with the leading writers, although there may generally be a cyclical trend in overall rate levels that may be seen in the rate levels of industry leaders.

Data Analysis

The data for this study was analyzed by market structure, market conduct and market performance (S-C-P). The basic tenet of the S-C-P paradigm is that the economic performance of an industry is a functional relationship between the conduct of the buyers and sellers and the industry's structure. The performance is a measure of how resources are maximized to yield the highest output. In this static model, long-run equilibrium of perfectly competitive markets will result in the optimal allocation of resources in an economy.

Market Structure Factors

In economics, market structure describes the state of a market with respect to competition. This refers to the extent to which any insurer controls all or a portion of the commercial liability insurance market and whether the total number of companies writing commercial liability insurance is sufficient to provide multiple options to clients. The focus is on those characteristics of the market that affect the degree of competition between firms. Traditionally, the emphasis is on the number and size distribution of buyers and sellers and the existence or absence of barriers to entry and exit. Market shares, product availability, and fully informed buyers and sellers are important aspects of market structure.

- Barriers to entry and exit: In the theory of competition, barriers to entry are obstacles in the path of a firm that make it difficult to enter a given market. Barriers to entry are the source of a firm's pricing power - the ability of a firm to raise prices without losing all its customers. The higher the barriers to entry and exit the more prone a market tends to be a natural monopoly. The reverse is also true. The lower the barriers to entry the more likely a market trends toward perfect competition. Barriers in the commercial liability insurance market could lead to a restraint of trade. One barrier is economies of scale. It is a practical concept that is important for explaining real world phenomena such as patterns of trade, the number of firms in a market, and how firms get "too big to fail."

- Market shares: Market shares denoted as a percent is calculated by dividing each direct premium written (dpw) by a single insurance group in the market by the sum of direct premium written by all the groups. Market share by group, rather than by individual company, was selected on the basis that groups more accurately reflect the number of distinct entities that are competing against one another for business in the market.

Top 10 Market Shares 2005 - 2009

Year	Rank	Company Name	Direct Premiums Written	Market Share	Cum. Market Share
2005	1	AUTO OWNERS GROUP	$68,252,257	14.28%	14.28%
2005	2	HANOVER INSURANCE GROUP	36,211,947	7.58%	21.86%
2005	3	TRAVELERS GROUP	28,231,746	5.91%	27.77%
2005	4	FRANKENMUTH GROUP	26,131,123	5.47%	33.24%
2005	5	CNA INSURANCE GROUP	21,846,495	4.57%	37.81%
2005	6	HASTINGS MUTUAL INSURANCE GROUP	18,138,996	3.80%	41.61%
2005	7	CINCINNATI FINANCIAL GROUP	17,600,228	3.68%	45.29%
2005	8	NATIONWIDE CORPORATION GROUP	16,638,444	3.48%	48.77%
2005	9	CHUBB & SON INC GROUP	16,279,445	3.14%	51.91%
2005	10	MI MILLERS MUTUAL INSURANCE COMPANY*	15,823,235	3.31%	55.22%

Year	Rank	Company Name	Direct Premiums Written	Market Share	Cum. Market Share
2006	1	AUTO OWNERS GROUP	$60,334,451	13.35%	13.35%
2006	2	HANOVER INSURANCE GROUP	34,186,331	7.56%	20.91%
2006	3	TRAVELERS GROUP	28,234,060	6.25%	27.16%
2006	4	FRANKENMUTH GROUP	23,352,055	5.17%	32.33%
2006	5	CNA INSURANCE GROUP	19,684,090	4.36%	36.69%
2006	6	CINCINNATI FINANCIAL GROUP	18,119,982	4.01%	40.70%
2006	7	NATIONWIDE CORPORATION GROUP	17,424,593	3.86%	44.56%
2006	8	LIBERTY MUTUAL GROUP	16,622,502	3.68%	48.24%
2006	9	HASTINGS MUTUAL INSURANCE COMPANY*	16,464,628	3.64%	51.88%
2006	10	CHUBB & SON INC GROUP	15,463,112	3.42%	55.30%

Top 10 Market Shares 2005 – 2009 (continued)

Year	Rank	Company Name	Direct Premiums Written	Market Share	Cum. Market Share
2007	1	AUTO OWNERS GROUP	$50,630,061	12.84%	12.84%
2007	2	HANOVER INSURANCE GROUP	29,508,953	7.49%	20.33%
2007	3	TRAVELERS GROUP	26,212,440	6.65%	26.98%
2007	4	FRANKENMUTH GROUP	18,913,477	4.80%	31.78%
2007	5	LIBERTY MUTUAL GROUP	18,565,123	4.71%	36.49%
2007	6	CINCINNATI FINANCIAL GROUP	15,748,040	4.00%	40.49%
2007	7	CHUBB & SON INC GROUP	14,590,054	3.70%	44.19%
2007	8	CNA INSURANCE GROUP	14,257,861	3.62%	47.81%
2007	9	NATIONWIDE CORPORATION GROUP	13,907,410	3.53%	51.34%
2007	10	HASTINGS MUTUAL INSURANCE COMPANY*	13,830,619	3.51%	54.85%

Year	Rank	Company Name	Direct Premiums Written	Market Share	Cum. Market Share
2008	1	AUTO OWNERS GROUP	$47,665,397	12.96%	12.96%
2008	2	HANOVER INSURANCE GROUP	27,226,735	7.40%	20.36%
2008	3	LIBERTY MUTUAL GROUP	23,944,859	6.51%	26.87%
2008	4	TRAVELERS GROUP	23,052,983	6.27%	33.14%
2008	5	FRANKENMUTH GROUP	17,412,121	4.76%	37.90%
2008	6	CHUBB & SON INC GROUP	14,602,688	3.97%	41.87%
2008	7	CINCINNATI FINANCIAL GROUP	13,751,359	3.74%	45.61%
2008	8	MI MILLERS MUTUAL INSURANCE COMPANY*	13,607,535	3.70%	49.31%
2008	9	CNA INSURANCE GROUP	13,457,682	3.66%	52.97%
2008	10	MI MILLERS MUTUAL INSURANCE COMPANY*	12,884,369	3.50%	56.47%

Year	Rank	Company Name	Direct Premiums Written	Market Share	Cum. Market Share
2009	1	AUTO OWNERS GROUP	$45,847,858	13.99%	13.99%
2009	2	HANOVER INSURANCE GROUP	24,125,804	7.36%	21.35%
2009	3	TRAVELERS GROUP	22,477,561	6.86%	28.21%
2009	4	FRANKENMUTH GROUP	15,834,796	4.83%	33.04%
2009	5	LIBERTY MUTUAL GROUP	14,631,278	4.46%	37.51%
2009	6	MI MILLERS MUTUAL INSURANCE COMPANY*	12,712,632	3.88%	41.39%
2009	7	HASTINGS MUTUAL INSURANCE COMPANY*	11,960,612	3.65%	45.04%
2009	8	CINCINNATI FINANCIAL GROUP	11,957,731	3.65%	48.69%
2009	9	PHILADELPHIA CONSOLIDATED HOLDING GROUP	11,786,361	3.60%	52.28%
2009	10	CHUBB & SON INC GROUP	11,355,114	3.47%	55.75%

Data Source: NAIC
*Company not part of a group

Based upon the above graphs it would appear that the market for commercial liability insurance is not dominated by only a few insurance companies. There is no indication that competition does not generally exist in this market. The top 10 writers share a little over 50 percent of the market.

- Information cost: Information is an important element of market structure and the efficient functioning of the insurance market. Information is important to producers and consumers, and both have an incentive to invest in this resource. Producers want information to aid in the identification of risk. Consumers will invest in research costs to identify the product at the most affordable cost that best suits their needs. Because information has value, markets have emerged to meet this need for both the buyer and the seller. In recent years, technology has reduced research and information costs. Markets operate with more efficiency than in the past because of the availability of low cost information.

- Product availability: Product availability is another important indicator of workable competition in the market. The insurance companies in the standard voluntary market are not required to sell their products to everyone. Standard insurance is insurance that one can obtain through the voluntary insurance industry at a preferred rate. Non-standard insurance is insurance for those clients whose underwriting experience makes it impossible to obtain insurance at standard or preferred rates, but may be an acceptable risk to certain companies at a higher premium. There are also some specialized types of commercial insurance which may only be available through the surplus lines market.

- Twelve of the largest brokers in Michigan who focus on multiple lines were contacted to provide information. They were asked whether the total number of companies writing commercial liability insurance in this state is sufficient to provide multiple options to commercial liability insurance purchasers; is there disparity among commercial liability insurance rates and classifications to the extent that such classifications result in rate differentials; and is there availability of commercial liability insurance to commercial liability insurance purchasers in all geographic areas and to all types of business?

- All responses were consistent, stating that the market in Michigan is more than sufficient to provide for purchasers multiple options and in most cases multiple quotes of commercial liability insurance.

- One agency stated: "It is our opinion that the availability for all the geographic areas in which we market is extremely strong." Another agency stated, "We find a reasonable disparity among liability insurance rates from carrier to carrier."

- In reviewing all responses, there is agreement that the commercial liability insurance market is very competitive and the product is readily available in all geographic areas.

Market Conduct Factors

Market conduct refers to the price and other market policies pursued by sellers. Behavior patterns are expected to follow from the various types of industry structure, particularly the basis on which an industry's member makes their basic price and output decisions, e.g., whether they set their respective prices and volumes independently or collusively.

An analysis of The Council of Insurance Agents & Brokers' 2009 survey by Barclays Capital Equity Research, illustrates that the average commercial account (all lines) had a 5.6 percent quarterly decline nationally during the fourth quarter of 2009 compared with the third quarter. For large accounts the rates were down 7.4 percent; for medium accounts renewal premiums were down 6.3 percent and for small accounts the renewal premiums averaged a 3.1 percent decline.

2008 Quarterly Rate Changes

Commission & fees	Small < $25K	Mid $25K-$100K	Large >$100K	Average
4Q08	-4.2%	-7.1%	-8.0%	-6.4%
3Q08	-7.8%	-12.1%	-13.2%	-11.0%
2Q08	-9.7%	-14.7%	-15.7%	-13.5%
1Q08	-10.0%	-14.7%	-15.7%	-13.5%

2009 Quarterly Rate Changes

Commission & fees	Small < $25K	Mid $25K- $100K	Large >$100K	Average
4Q09	-3.1%	-6.3%	-7.4%	-5.6%
3Q09	-3.6%	-6.5%	-7.4%	-5.8%
2Q09	-2.5%	-5.7%	-6.7%	-4.9%
1Q09	-3.3%	-5.6%	-6.4%	-5.1%
High (4Q01)	20.8%	31.7%	33.0%	28.5%
Low (3Q07)	-10.0%	-15.0%	-15.9%	-13.6%

Source: Council of Insurance Agents & Brokers
Chart prepared by Barclays Capital Equity Research

The commercial liability insurance market was "soft" in 2008 and 2009. A soft market is represented by more sellers than buyers. Low prices result from this excess of supply over demand. The continuing economic crisis has reduced the amount of risk available to insure because of many business closures and no new businesses being started. It is still uncertain if 2010 will see a hardening of the market.

Commercial Property – Casualty Market Survey
Fourth Quarter 2009 Released: January 2010

This survey includes many commercial liability lines. This will illustrate how the other commercial liability products are being price in comparison to each other.

Below are the survey results for the Midwest (AR, IL, IN, IA, KS, MI, MO, MN, NE, ND, SD, OH, WI). The questions on the survey were:

Chart #1 - On average, how have premium rates changed over the last three months (Oct. 1 - Dec. 31, 2009) for the following accounts?

Lines of Insurance	Down 30 - 40%	Down 20- 30%	Down 10- 20%	Down 1- 10%	No Change	Up 1- 10%	Up 10- 20%	Up 20- 30%	Up 30- 50%	Up 50- 100%	N/A
Small ($25K Commission & Fees)	0%	0%	9%	41%	41%	5%	5%	0%	0%	0%	0%
Medium ($25K- $100K)	0%	0%	23%	55%	18%	0%	5%	0%	0%	0%	0%
Large (>$100K)	0%	9%	18%	50%	9%	5%	5%	0%	0%	0%	6%

Source: Council of Insurance Agents & Brokers - Chart: Barclays Capital Equity Research

Chart #2 - How much have premium rates changed over the last three months (Oct. 1 - Dec. 31, 2009) for the following lines? Please check N/A if you don't know or don't handle the line.

Lines of Insurance	Down 30- 40%	Down 20- 30%	Down 10- 20%	Down 1- 10%	No Change	Up 1- 10%	Up 10- 20%	Up 20- 30%	Up 30 - 50%	Up 50 - 100%	N/A
Business Interruption	0%	0%	9%	36%	45%	0%	0%	0%	0%	0%	9%
Broker E & O	0%	0%	0%	23%	45%	5%	0%	0%	0%	0%	27%
Commercial Auto	0%	0%	14%	55%	27%	0%	0%	0%	0%	0%	5%
Commercial Property	0%	6%	18%	64%	14%	0%	0%	0%	0%	0%	0%
Construction Risks	0%	0%	9%	27%	50%	0%	0%	0%	0%	0%	14%
D & O	0%	0%	5%	23%	45%	18%	0%	0%	0%	0%	9%
Flood Insurance	0%	0%	5%	18%	55%	5%	0%	0%	0%	0%	18%
Employment Practices	0%	0%	5%	14%	64%	5%	0%	0%	0%	0%	14%

General Liability	0%	0%	18%	55%	18%	5%	0%	0%	0%	0%	5%
Marine	0%	0%	14%	27%	14%	0%	0%	0%	0%	0%	18%
Surety Bonds	0%	0%	0%	5%	64%	5%	0%	0%	0%	0%	27%
Terrorism	0%	0%	0%	9%	82%	0%	0%	0%	0%	0%	9%
Umbrella	0%	0%	23%	45%	23%	5%	0%	0%	0%	0%	5%
Workers' Compensation	0%	0%	18%	36%	41%	0%	0%	0%	0%	0%	5%

Source: Council of Insurance Agents & Brokers
Chart: Barclays Capital Equity Research

Market Performance Factors

Market performance refers to the end results of these market policies; the ultimate economic results that are produced by the conduct patterns prevailing in an industry. A useful index of the industry's overall efficiency and market performance is the statewide loss index. This loss ratio reveals the amount of actual loss protection received for each premium dollar paid. A loss ratio is calculated by dividing incurred losses by premium earned during the policy period. All else being equal, a high loss ratio would suggest decreased profitability, and a low loss ratio would imply increased profitability. High rates and lack of competition would result in low loss ratios. Conversely, a competitive market with lower rates would tend to result in high loss ratios. This loss ratio needs to be low enough to permit a commercial liability insurer to earn a fair rate of return on investment that is consistent with workable competition.

Commercial Multiple Peril Liability
Pure Loss Ratio

	2009	2008	2007	2006	2005	2004	2003	7 Year Average
IL	46.61%	50.62%	40.12%	43.31%	46.24%	53.00%	2003	56.13%
IN	51.68%	57.00%	61.13%	52.36%	58.11%	57.26%	56.86%	66.57%
MI	23.75%	35.65%	25.59%	28.21%	26.87%	39.85%	61.85%	38.70%
MN	33.16%	43.05%	40.02%	43.98%	45.70%	64.94%	52.31%	71.50%
NY	51.60%	45.35%	46.33%	56.83%	55.07%	62.76%	158.09%	62.45%
OH	23.54%	34.56%	28.42%	28.03%	45.78%	43.44%	56.75%	42.50%
PA	45.59%	59.88%	48.99%	52.10%	52.15%	49.69%	51.20%	60.54%
WI	37.14%	32.77%	34.15%	38.28%	42.85%	46.90%	54.83%	46.34%
U.S.	36.96%	42.30%	36.93%	42.72%	45.99%	49.63%	45.96%	51.94%

Loss Ratio % = Loss Incurred / Premiums Earned
Source of Data: NAIC

Michigan's commercial multiple peril liability market has been functioning with a low loss ratio when compared to other states in the graph and the U. S. market. Michigan's market over a 7-year average is also below all of the other represented states and the U.S. market.

Very low loss ratios are seen as evidence that an insurance market is overcharging and making excess profits. It is collecting much more in premiums than it needs to cover claims. Very high loss ratios are seen as evidence that an insurance market is in poor financial health. It is not collecting enough premiums to cover claims, pay expenses and make a reasonable profit.

Michigan Commercial Multiple Peril
(Liability portion)
In Actual Dollars 2003 - 2009

Calendar Year	Direct Premium Written (less surplus lines)	Annual Percent Change dpw	Loss Ratio
2003	453,170,004	4.95%	51.89%
2004	470,656,620	3.86%	36.07%
2005	469,084,485	-0.33%	27.60%
2006	442,303,051	-5.71%	27.81%
2007	385,546,436	-12.83%	25.13%
2008	361,473,219	-6.34%	35.97%
2009	321,536,396	-11.05%	22.62%
7-year average	$414,824,316	-3.92%	32.44%

Loss Ratio % = Loss Incurred / Premiums Earned
Source: Michigan Office of Financial and Insurance Regulation

In reviewing the above information of loss ratios of all insurance companies that wrote commercial liability insurance in Michigan over the last 7-year period, the average loss ratio was 32.44 percent. The loss ratio over this period ranged from a high in 2003 at 51.89 percent to a low of 22.62 percent in 2008. All the changes represented in this chart may have resulted from:

- Net increase or decrease of commercial enterprises in Michigan;
- Rate increases or decreases imposed by insurance companies to compensate for high or lower costs of claims;
- Higher or lower limits of coverage purchased by some insured due to inflationary forces or business requirements.

As previously stated, a loss ratio is calculated by dividing the incurred loss by premium earned during a policy period. This ratio may or may not represent the real financial return to the company. The incurred losses are driven by the occurrence of catastrophic events or high risk underwriting. Higher risk policies will tend to have a negative effect on incurred losses. Premium growth can be achieved by risky underwriting practices; lower risk would be due to more conservative underwriting policy.

Aside from claims-related expenses, the profitability of insurers is affected by commissions paid to brokers/agents, administrative expenses, debt service, and overhead costs. A company that manages these costs better than their competition will tend to be more successful.

Investment income also contributes to the financial success of a company. Insurers will maintain some liquidity in their portfolios so claims can be paid on a timely basis. The balance of their portfolios may be invested in stocks and bonds or other investments which will generate income. For instance, a company may generate low underwriting returns but produce high net income due to the income from its investment portfolio.

In summary, commercial liability companies in Michigan have experienced a seven year loss ratio average of 32.44 percent or a 19.45 percent increase in profitability over the seven year period. If a Michigan company has managed cyclicality effectively, consistently practiced conservative underwriting, and diversified investments to minimize risks, it has out performed its counterparts in many states.

Surplus Lines

Insurance surplus lines coverage originated when those who needed insurance coverage were unable to secure it from the standard carriers for a variety of reasons:

- The risk did not meet the guidelines of the standard market due to age, location, loss history or cancellation;
- The policy limits exceeded the limits for the standard market;
- The risk was "extraordinary" and the standard carriers may not have been comfortable covering such a risk because of the high potential for loss.

Michigan Surplus Lines
2003 - 2009

Year	Direct Premium Written	Loss Ratio %	Direct Premium Written (including surplus lines)	Loss Ratio % (including surplus lines)	Direct Premium Written Surplus Lines	Surplus Lines % of Total Direct Premium Written
2003	453,170,004	51.89%	462,048,435	52.19%	8,878,431	1.96%
2004	470,656,620	36.07%	479,061,158	37.42%	8,404,538	1.79%
2005	469,084,485	27.60%	477,740,714	26.69%	8,656,229	1.85%
2006	442,303,051	27.81%	451,555,050	27.84%	9,251,999	2.09%
2007	385,546,436	25.13%	394,149,994	25.61%	8,603,558	2.23%
2008	361,473,219	35.97%	367,813,247	35.85%	6,340,028	1.75%
2009	321,536,396	22.62%	327,681,484	22.35%	6,145,088	1.91%
7-year Average	$414,824,316	32.44%	422,864,297	32.56%	$8,039,982	1.94%

Loss Ratio % = Loss Incurred / Premiums Earned
Source: Michigan Office of Financial Insurance Regulation

Market share of the surplus lines in the commercial liability is a small part of the total market share averaging less than 2 percent over the past seven years.

Findings for 2009

(a) The market for commercial liability insurance is not dominated by a few insurance companies. There is no indication that competition does not generally exist in this market. The top 10 writers in 2009 share 55.7 percent of the market, down from 56.47 percent of the market in 2008, with no concentration in the market.

(b) Except for extremely hazardous classes of business, buyers have many options when purchasing commercial liability insurance in Michigan.

(c) The prices dropped and competition between carriers increased in 2009. Any disparity in rates seems to be caused by decreasing rates and competition.

(d) There seems to be no issue of availability or pricing based upon geography.

(e) Market share of the surplus lines in the commercial liability is a small part of the total market share averaging fewer than 2 percent over the past seven years.

CERTIFICATION OF THE STATE OF

COMPETITION IN THE

COMMERCIAL LIABILITY INSURANCE MARKET

I hereby certify that, based on the results of the economic tests specified in section 2409c of the Insurance Code of 1956, 218 PA 1956, MCL 500.2409c, a reasonable degree of competition exists at this time, with respect to the Michigan commercial liability insurance market.

Ken Ross
Commissioner